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C O N F I D E N T I A L SECTION 01 OF 03 COLOMBO 000745

SIPDIS

DEPARTMENT FOR SCA/INSB, EEB/IFD/OIA, EAP/CM, EAP/EP

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SUBJECT: SRI LANKA: CHINESE INFLUENCE ON THE RISE

Classified By: Charge d'Affaires James R. Moore for reasons 1.4 b) and d)

¶1. (C) Summary. China has emerged as Sri Lanka,s strongest supporter in the post-war reconstruction era, providing funding for projects ranging from power plants to weapons. China has a long-standing goal of increasing its influence in the region, especially at the expense of India, the other regional power in the area. Chinese Commercial Counselor, Zhu Jinfu, said that China will continue increasing aid and investment to Sri Lanka. Zhu also noted that the extent of Chinese investments in Sri Lanka may be exaggerated by local media. Chinese direct investment and economic support in Sri Lanka, particularly in infrastructure development, could bring significant economic growth and rapid post-war recovery to the island. However, this growth and development could come at the cost of U.S. influence. End summary.

¶2. (SBU) China has emerged as Sri Lanka,s strongest supporter in the post-war reconstruction era, providing funding for projects ranging from power plants to weapons. International media report that China increased its aid to Sri Lanka fivefold to \$1 billion per year. Local businessmen claim that, in the last two years, China has committed \$2.5 billion dollars to various projects in Sri Lanka with another \$1 billion in the pipeline.

¶3. (SBU) China has a long-standing goal of increasing its influence in the region, especially at the expense of India, the other regional power in the area. Sri Lanka presents an especially attractive ally to China because of its strategic location overlooking the shipping lanes that carry much of the world,s oil trade. Chinese military ordnance was crucial in the final months of the conflict. Even before the end of the civil war, China was generous in offering money and aid to the government.

¶4. (SBU) China has been a generous partner to Sri Lanka, offering funding and labor to the government whenever needed. The Bandaranaike Memorial International Hall, built by the Chinese in 1972, is regarded as a symbol of the friendship between the two countries. The Cultural Complex under construction in Colombo is a continuation of that friendship. China also funded and built the Sri Lanka Supreme Court complex.

China Investment Increasing but True Extent Exaggerated

¶5. (SBU) In a meeting with the Economic Officer, Chinese

Commercial Counselor, Zhu Jinfu, said that China plans to continue increasing aid and investment to Sri Lanka. He noted that the government of Sri Lanka has asked China for help with large infrastructure projects, and Chinese firms are very willing to bid on the projects. Zhu also said that the Sri Lankan media, he believed, at the behest of the Sri Lankan government, is widely publicizing major Chinese investments in order to get other countries to increase their direct investment in Sri Lanka. He mentioned two recently announced projects - a special economic zone and a housing development loan; Zhu said that neither had been approved by the Chinese government and that it was unlikely either project would be completed.

¶6. (SBU) According to the investment promotions office of the Sri Lankan Board of Investment, China is often the sole bidder on projects. A Chinese/Sri Lankan consortium was the only bidder on a project to redesign and build a new container terminal at the Colombo Port even though the government extended the bid deadlines and relaxed some of the technical criteria in order to attract additional bidders. Chinese companies, usually state-owned enterprises, have a significant advantage over private firms and consortiums because they have the financial backing of the Chinese Export-Import Bank (Exim Bank). Also, in many cases, the Chinese companies can bring their own cheap labor, providing additional savings.

¶7. (SBU) Outside of the many investments and projects being funded by Chinese companies and government, there have been several instances where China simply gives Sri Lanka money.

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On July 25, the China Development Bank and the Central Bank announced an Investment Facilitation Agreement under which the Chinese bank would place a US dollar deposit of \$25 million with the Central Bank of Sri Lanka. The deposit, being referred to as a grant by the local media, is seen as a sign of the strong economic ties between the two countries.

Americans Wary of Sri Lanka

¶8. (SBU) The Sri Lanka Board of Investment (BOI) noted in a meeting with EconOff that it accepts bids from whichever countries and firms are willing to supply capital. The BOI said it would be pleased to partner with the United States on upcoming development projects. The Minister of Enterprise Development and Investment Promotion, Anura Priyadarshana Yapa, and three other BOI personnel were recently in the United States as part of an effort to encourage investment in Sri Lanka. Upon his return, the BOI announced that (begin quote) As much as \$25 million as foreign investment is expected to Sri Lanka from the USA (end quote). Unlike similar announcements of new Chinese investments, no mention was made of any company or tender or agreement that had been signed.

¶9. (SBU) Many U.S. companies are wary of putting money into Sri Lanka. The government bureaucracy is inefficient, difficult to navigate, and corrupt. Infrastructure is inadequate and poorly maintained. U.S. companies don't have the financial resources to compete with Chinese state-owned enterprises or consortiums that are supported by the Chinese government. According to the American Chamber of Commerce in Sri Lanka Director Chullante Jayasuriya, U.S. companies are still waiting for financial conditions to normalize in Sri Lanka and in the world economy before contemplating new investments. He said that he was worried that American companies were falling behind China in the bid for new business opportunities.

Ports, Power Plants, and Economic Zones

¶10. (SBU) It is difficult to estimate the true extent of Chinese business involvement in Sri Lanka. Almost every day brings mention of new projects and investments being made by Chinese companies and banks. Following is a sampling of some of the larger projects being supported by Chinese capital and labor. If all were to be completed, they would represent over \$2 billion in Chinese capital. Counselor Zhu told the EconOff that some of these projects have not yet been approved by the Chinese government. However, the Embassy has not made any public statements disclaiming responsibility for the projects.

¶11. (U) Hambantota Port project: In 2007, the Sri Lanka Port Authority (SLPA) signed an agreement with two Chinese firms, China Harbour Engineering Company Ltd and Syno Hydro Corporation Ltd, to finance the development of a deep-water port in Hambantota, located on the Southern coast. Hambantota is the home constituency of President Mahinda Rajapaksa. The award of the project to China was widely seen as a move to cement good relations between the two countries. The total cost of phase one alone is estimated to be \$360 million. The port is designed for possible future expansion, should Colombo Port not be able to meet expansionary demands. According to local media, in addition to the port development, China's ExIm Bank extended to Sri Lanka a \$65 million loan to build an oil storage facility with a capacity of 82,000 cubic meters of fuel storage in Hambantota.

¶12. (U) Energy sector development: The Norochcholai coal-fired power plant in Puttalam is another large Chinese-financed project. The first phase of the project, a 300MW plant for the Ceylon Electricity Board state power utility, is being built by China's CMEC construction company, and it is scheduled to be completed by the end of 2010. China's ExIm Bank recently awarded Sri Lanka a soft loan of \$891 million--repayable over 20 years with a 2% interest rate--for completion of the plant. The second phase of the project will consist of two power plants, each with a

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capacity of 300MW, to bring the Norochcholai plant's total capacity to 900MW, roughly half of the country's 2,000MW energy needs. According to local media, China also has expressed interest in offshore oil exploration, and one block of Sri Lanka's offshore fields has been awarded to China for future exploration.

¶13. (SBU) Exclusive economic zone for Chinese investors: The Sri Lankan Board of Investment (BOI) signed a deal worth \$28 million with Hong Kong-based Huichen Investment Holdings Ltd to manage a 161 acre special economic zone, located just north of Colombo in Mirigama, that will cater to Chinese investors. This deal represents the first time the BOI has handed over land for development by a foreign company. Counselor Zhu said that all special economic zones must be approved by the Chinese government, and that the proposal for the special economic zone in Sri Lanka had been denied by Beijing. There has been no mention of this in the media or by the GSL.

¶14. (U) Housing development: According to local media, the Chinese government extended a concessionary loan of Rs. 120 billion (roughly \$1.04 billion) to build over 130,000 housing units country wide. Zhu said that the project, which he said was signed with a very small company, was exaggerated. He believed it was impossible for such a small company to take on such a large, over \$1 billion project. The agreement was signed between the Ministry of Construction and Engineering Services and the International Economic and Technology Cooperation of China on July 15.

Comment

¶15. (C) China,s economic and diplomatic clout in Sri Lanka continues to increase. The economic crisis, recent controversy over the IMF loan to Sri Lanka, and continued Western criticism of human rights abuses and humanitarian conditions in the North and the East during and after the war with the Tamil Tigers have brought the two countries closer together. China,s willingness to provide aid without strings attached is seen as a welcome alternative to a government chafing under the criticism of western countries. The draft 2010 Senate Appropriations Bill (S.1434) that contains language suspending foreign military funding and loans to Sri Lanka unless the Secretary of State certifies that the Sri Lankan government has met certain conditions will likely, if passed, further push Sri Lanka towards China. Chinese direct investment and economic support in Sri Lanka, particularly in infrastructure development, could bring significant economic growth and rapid post-war recovery to the island. However, this growth and development could come at the cost of U.S. influence.

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